

20 June, 2000

The Honourable Ronald Arculli
Chairman of the Sub-Committee
on the Securities and Futures Bill
Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Mr. Arculli:

Proposed Amendments to The Securities (Disclosure of Interests) Provisions in the Securities and Futures Bill (“Bill”)

This letter relates to and supplements the letter dated May 22, 2000 sent to you by Linklaters on behalf of the group of international financial institutions named in such letter. We are recommending herein expanding the scope of Section 309(5) of the Bill that deals with disaggregation of certain interests to accommodate financial institutions that provide a number of financial services, including fund management services, within the same corporate entity.

1. Our Proposal

We would recommend expanding the exception contained in Section 309(5) to permit disaggregation when, from a factual and functional perspective, a single corporation maintains separate business units that conduct investment management, custodial and trustee services (collectively, “Investment Management Services”), but which businesses operate independently under objective standards and policies from the other business units in such corporation. We do not believe that there is any reason to distinguish between Investment Services conducted in separate business units from Investment Services conducted in separately formed corporations within a corporate group, if such business units otherwise meet the requirements set forth in Section 309(5).

2. The Bill

Section 309(5) of the Bill provides that a person is not required to aggregate its interest in shares with a corporation that (i) has interests in such shares only by reason of its being an investment manager, custodian or trustee; (ii) exercises its right to vote such shares independently from such person; and (iii) exercises its power to invest in, manage, deal with and hold such shares independently from such person.

In April 1999, the SFC published the results of its public consultation on the Securities (Disclosure of Interests) Ordinance (“SFC Consultation”). The consultation paper noted that the determination of whether voting and investment powers are exercised independently is a factual one. The factors used to make such determination include, among others, (i) who actually makes decisions regarding interests in the relevant shares and (ii) whether information barriers exist to ensure such independence. In Section 13.25 of the Government’s consultation document of April 2000 (the “Consultation Paper”), the Government has proposed to codify this concept. Section 13.25 is also seeking industry participants’ views whether further modifications should be made to Section 309(5).

3. Our Rationale

Though the SFC Consultation and the Consultation Paper focus on separately formed corporations within a corporate group rather than business units within a single corporation, we believe that the requirements contained in Section 309(5) can be satisfied by separate business units of a single corporation. We also believe that treatment of separate business units of a multi-service financial institution as subject to *per se* aggregation would be unwarranted in light of the functional approach to regulation described in the SFC Consultation and the principles encompassed in the Bill. In our view, there is no real basis for treating separately identifiable business units within a corporation in a manner different than affiliated companies when the organizational structure of such units is such that the voting and investment powers over the relevant securities are in fact exercised independently and strict information barriers between such divisions effectively preclude the inappropriate flow of information among the units. If a business unit makes investment decisions for clients independently of sales and trading activities and without regard to the holdings of or consultation with other business units within a corporation, we see no reason why such separate business unit should be treated differently than a separately formed corporation.

At Goldman Sachs globally, the investment management function in many instances, including Goldman Sachs (Asia) L.L.C., is conducted in a separate business unit, rather than through a separately formed corporation. In all such cases, we have procedures in place to ensure that our investment management division is independent with respect to its voting and investment powers through such means as (i) effective information barriers, including physical separation of such business from all other businesses; (ii) maintaining and enforcing written policies and procedures relating to such barriers (subject to limited wall crossing); (iii) performing periodic independent assessments of our policies relating to such barriers; (iv) ensuring that advisory personnel responsible for making portfolio selection and trading decisions are devoted exclusively to the business of the investment management division; and (v) compensating investment management personnel in such a way that their salaries are not directly dependent on the trading activities of the firm. We do not believe that a separate formal corporate structure would enhance substantively the measures we have in place to ensure the proper independence of our investment management division.

4. Drafting Comments

To implement the changes suggested in this letter, we would suggest that the concept of a “business unit or division” be utilized in Section 309(5) in addition to the word “corporation” where applicable. For example, clause (5)(i) of such Section would state “that corporation, *business unit or division (as the case may be)* is interested in those shares or has a short position in those shares (as the case may be) by reason only of its obligation or power to invest in, manage, deal with or hold interests in those shares...” (emphasis added).

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We hope that you find these comments useful and would be pleased to discuss them with you if you would like. Please contact the undersigned with any questions or comments you may have.

Very truly yours,

Pamela P. Root

cc: Ms. Au King-Chi, The Financial Services Bureau
Mr. Mark Dickens, Securities and Futures Commission